STATE OF MICHIGAN
IN THE SUPREME COURT

(ON APPEAL FROM THE MICHIGAN COURT OF APPEALS)
SAWYER, P.J., JANSEN AND GAGE, J.J.

EILEEN V. GRAVES,

Plaintiff-Appellant,

v

AMERICAN ACCEPTANCE MORTGAGE CORPORATION,

Defendant-Appellee,

and

BOULDER ESCROW, INC., a Nevada Corporation,

Defendant-Appellee/Counter and Cross-Plaintiff.

and

STEVE DIAZ,

Defendant/Counter and Cross-Defendant.
_____/

Supreme Court No. 119977

Court of Appeals No. 215141

Oakland County Circuit Court
No. 96-511648-CZ

BRIEF ON APPEAL OF DEFENDANTS-APPELLEES AMERICAN ACCEPTANCE MORTGAGE CORPORATION AND BOULDER ESCROW, INC.

ORAL ARGUMENT REQUESTED

CERTIFICATE OF SERVICE

MICHAEL J. HAGERTY (P29254)
Attorney for Defendants-Appellees
American Acceptance Mortgage Corporation
and Boulder Escrow, Inc.
622 East Grand River Ave.
Howell, Michigan 48843
(517) 548-3130

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COUNTER-STATEMENT OF APPELLATE JURISDICTION

This Court granted Leave to Appeal on January 28, 2003. Jurisdiction exists under MCR 7.301(A)(2).

COUNTER-STATEMENT OF THE QUESTIONS PRESENTED

I.

WHETHER THE COURT OF APPEALS CORRECTLY DETERMINED THAT THE LEGAL TITLE OF A LAND CONTRACT VENDOR IS A SEPARATE ESTATE IN LAND THAN THE EQUITABLE TITLE OF THE LAND CONTRACT VENDEE?

Appellant contends the answer is "No".

Appellees contend the answer is "Yes".

II.

WHETHER THE COURT OF APPEALS CORRECTLY RULED THAT MICHIGAN RECORDING LAWS DO NOT APPLY WHEN A PRIOR RECORDED LIEN AGAINST A LAND CONTRACT VENDEE'S EQUITABLE TITLE BECOMES SUBJECT TO A SUBSEQUENT PURCHASE MONEY MORTGAGE WHOSE PROCEEDS ARE USED BY THE VENDEE TO ACQUIRE THE LEGAL TITLE?

Appellant contends the answer is "No".

Appellees contend the answer is "Yes".

III.

WHETHER AMERICAN ACCEPTANCE IS EQUITABLY SUBROGATED TO THE RIGHTS OF THE LAND CONTRACT VENDORS WHO CONVEYED LEGAL TITLE TO THE VENDEE BASED UPON PAYMENT OF ITS PURCHASE MONEY MORTGAGE PROCEEDS.

Appellant contends the answer is "No".

Appellees contend the answer is "Yes".

COUNTER-STATEMENT OF FACTS AND MATERIAL PROCEEDINGS

BECAUSE APPELLANT IMPROPERLY ATTACHED CERTAIN EXHIBITS TO HER BRIEF (THAT BEING A-D) INSTEAD OF PUTTING THEM IN HER APPENDIX, THOSE DOCUMENTS SHALL BE REFERRED TO IN THIS BRIEF AS "ATTACHED TO APPELLANT'S BRIEF EXHIBIT ___."

On August 25, 1987 Appellant Eileen V. Graves, then known as Eileen V. Pretto, ("Graves") and her ex-husband, Steve Diaz ("Diaz") executed a land contract for the purchase of 72 West End ("property"), located in Waterford, Michigan with the fee simple owners, John and Paula Giordano ("Giordanos"). Attached to Appellant's Brief Exhibit A. This contract was never recorded. Graves and Diaz purchased several rental properties in the Pontiac, Michigan area and owned various interests in properties located at 40 West End, 61 West End, 80 Monterey, and 1048 LaSalle, all of which were addressed in the divorce judgment. On April 7, 1994 the Giordanos wrote to Graves regarding default on the contract. Appellee Appendix 1b. On June 6, 1994, Graves and Diaz were divorced pursuant to a Judgment Attached to Appellant's Brief Exhibit B. Diaz was residing at 72 West End. At the time of the divorce, Graves and Diaz owed approximately $24,000.00, the entire balance being due on August 25, 1994. See Payoff Statement, 08/23/94, Appellee Appendix, 2b.

In August of 1994, Diaz applied for a mortgage loan from Appellee American Acceptance Mortgage Corporation ("American Acceptance") to pay the land contract balance and obtain the fee simple title. American Acceptance retained Metropolitan Title Company ("MTC") to prepare a title commitment. MTC conducted a search of the Oakland County Register of Deeds' ("OCRD") records (both grantor-grantee and tract indexes). The record reflected fee simple title of 72 West End owned by the Giordanos. There was no recorded interest of Diaz or Graves. The OCRD records were only indexed to within approximately two weeks of the then current date

(indexing date varied based upon volume of recordings and available clerical staff) The OCRD did not maintain an "entry book" (discussed herein).

Prior to and at the closing, Diaz did not produce a copy of the land contract. The American Acceptance mortgage loan was closed on September 7, 1994. On this date Diaz executed these documents relevant to the appeal: 1) a mortgage in the amount of $22,000 to American Acceptance ("Diaz Mortgage"), and recorded on October 5, 1994. (The Diaz mortgage was assigned to Boulder Escrow, Inc. - not a party to this appeal.) Attached to Appellant's Brief Exhibit C; and, 2) an affidavit verifying that there were no liens on the property other than reflected in the title commitment (which reflected none), Appellee Appendix 3b; and, 3) a settlement statement, Appellee Appendix 5b-6b. The entire loan proceeds were used to pay the Giordanos the balance due on the land contract and they delivered a Warranty Deed to Diaz dated September 13, 1994 and recorded October 6, 1994, Appellee Appendix 4b. On September 7, 1994 at 8:54 a.m. Graves recorded a certified copy of the Judgment, with attached tax descriptions for the properties referenced therein. American Acceptance did not have any knowledge whatsoever of Grave's lien until she contacted it within weeks *after* the closing. Attached to Appellant's Brief Exhibit B.

Diaz defaulted on the mortgage and he failed to pay Graves the amounts due under the Judgment. Graves began an action against American Acceptance, alleging that she had a "first lien" on 72 West End, superior to the Diaz Mortgage. Diaz filed a bankruptcy petition that stayed the proceedings for over a year. The bankruptcy case was dismissed. The stay was lifted. On April 2, 1997 a Default Judgment/Consent Judgment of Foreclosure was entered. Appellee Appendix 7b-9b.

On April 23, 1997, Graves and American Acceptance, and their attorneys appeared before Judge Schnelz for hearing on the cross motions for summary disposition on the issue of priority. After considerable discussion, a proposed Settlement Agreement was placed on the record. Appellee Appendix 10b-19b. Shortly after this hearing, Graves' attorney withdrew. Graves failed to obtain the deed from Diaz required by the settlement agreement. A Clerk's Deed dated June 10, 1997 was issued on the foreclosure of the Diaz Mortgage. Appellee Appendix 20-b-23b. The redemption period expired on December 10, 1997.

On December 12, 1997, the case was reassigned to Judge Alice Gilbert. American Acceptance renewed its Motion for Summary Disposition before Judge Gilbert and requested a determination of the priority issue as called for by the April 23, 1997 Settlement. At the scheduled hearing on the American Acceptance Motion on June 10, 1998, Judge Gilbert did not rule on the Motion, and instead, requested Graves to file a Cross Motion for Summary Disposition. The Motions for Summary Disposition were heard on August 19, 1998. Judge Gilbert issued her Opinion and Order on September 29, 1998.

ARGUMENT

INTRODUCTION

In their respective Briefs on Appeal, Eileen Graves ("Graves") and the Real Property Law Section ("RPLS") misstate Michigan law regarding estates in land, land contracts, and encumbrances, and they distort their relationships and relative priorities. Their arguments fail to provide any sound reasons for this Court to disregard the purchase money mortgage doctrine, and they misstate and misapply the Michigan recording laws. Their references to recent legislation are inapplicable to this case, and the asserted conflicts between the law applicable in this case and such recent legislation are misperceived.

A careful analysis of the applicable Michigan law and the facts will reveal that the Court of Appeals reached the only possible correct decision. Its decision was based upon a proper identification of the different estates in land that were encumbered by Graves' lien and the American Acceptance mortgage. The Court then correctly decided that Michigan's recording statutes did not determine the priority of the lien and the mortgage, and that the purchase money mortgage doctrine applied to obtain the fundamentally fair result mandated by Michigan law.

I. THE COURT OF APPEALS CORRECTLY DETERMINED THAT THE LEGAL TITLE OF A LAND CONTRACT VENDOR IS A SEPARATE ESTATE IN LAND THAN THE EQUITABLE TITLE OF THE LAND CONTRACT VENDEE.

A. The issue regarding the nature of the estates.

Before a correct determination of a priority issue can be made, such as that now before the Court, the nature and extent of the *estates in land* involved must be properly identified. This identification will impact the determination of the priority of any *encumbrances* on the estates. The concept of estates in land underlies all of Michigan's real property law. In Michigan, in large part, estates in land are defined by statute. MCLA 554.1 et seq., MSA 26.1 et seq. On any one parcel of real property, many different estates in land can exist simultaneously. The paramount estate is the fee simple estate. Lesser estates include, but are not limited to, joint tenancies, tenancies in common, remainders, leasehold estates, and *equitable estates*.

The Supreme Court in *Smith v Smith*, 290 Mich 143, 287 NW 411 (1939) addressed the need, in all cases such as this, to carefully consider the different estates in land when, citing its prior decision in *Mandlebaum v McDonell*, 29 Mich 78, 18 Am Rep 61 (1874), it stated:

> Here, for the sake of certainty and stability, the law has classified and defined all the various interests and estates in lands which it recognizes the right of any individual to hold or create, and the definition of each is made from, and the estate known and recognized by the combination of certain legal incidents, many

> of which are so essential to the particular species of estate that they cannot, by the parties creating it, be severed from it, as this would be to create a new and mongrel estate unknown to the law and productive of confusion and uncertainty.

Id. at 92.

> Certainty in the law of real estate, as to the incidents and nature of the several species of estates and the effect of the recognized instruments and modes of transfer, is of too much importance to be sacrificed to the unskillfulness, the whims or caprices of a few peculiar individuals in isolated cases.

Id. at 107.

This case presents an issue about the different estates in land owned by land contract vendors and vendees.

B. The "equitable" estate created by a land contract.

All of the arguments made by Graves and the RPLS require a proper identification of the estates in land owned by a land contract vendor and a land contract vendee. Typically, a land contract vendor owns a fee simple estate which is the *paramount* estate in land. A land contract vendor could itself also be a land contract vendee on a prior land contract. (For discussion purposes, and because, in this case, the Giordanos did own the fee simple estate, the vendor's interest will be referenced herein as the fee simple estate.) A land contract vendee owns an estate in land referred to as the "equitable" estate. *Bowen v Lansing*, 129 Mich 117, 88 NW 384 (1901). The equitable estate created under a land contract includes the *right* to acquire the fee simple estate by paying for it. The vendee also has a separate obligation to make payment under a land contract.

Upon execution of a land contract, the fee simple estate continues to be owned by the vendor, however, it is subject to the vendee's right to obtain that estate upon payment. The vendor also has a separate right to payment under the land contract. Both the vendor and the vendee own estates in land. They are different estates in land, and they exist simultaneously. The

vendee's estate is commonly described as the *equitable title*. The vendor's estate is commonly referred to as *legal title*. A land contract vendee's equitable title is a lesser estate than the legal title because, until payment, it has not yet been acquired. This is the essence of a land contract in Michigan.

C. Graves' prior recorded judgment lien could not have attached to any greater interest than Diaz' "equitable" title at the time it was recorded.

Graves frames her second issue on appeal as follows:

> DID THE COURT OF APPEALS ERR IN FAILING TO RECOGNIZE THAT A LAND CONTRACT VENDEES INTEREST IS A PRESENT INTEREST IN REAL ESTATE, SUBJECT TO ATTACHMENT BY A JUDGMENT LIEN HOLDER?

Graves' Brief on Appeal at vii, 12 (emphasis added).

In fact, the Court of Appeals specifically stated:

> In this case, the June 1994 judgment of divorce granted plaintiff a lien on 72 West End to the extent of Diaz' then existing interest in the property. *At the time of the judgment lien's creation, Diaz, the land contract vendee, possessed equitable title in 72 West End. Bowen v Lansing*, 129 Mich. 117, 118-119; 88 N.W. 384 (1901); *Tidwell v Dasher*, 152 Mich. App. 379, 386; 393 N.W.2d 644 (1986). *Thus, plaintiff had a lien to the extent of Diaz' equitable interest in the property.* Diaz did not obtain legal title to 72 West End until 1996 when he satisfied his obligation under the land contract. The mortgage Diaz granted American Acceptance constituted a purchase money mortgage because Diaz, who had defaulted on his land contract payments, utilized the proceeds of this mortgage to obtain legal title to 72 West End by paying off his land contract vendors. *Graves v American Acceptance,* 246 Mich App 1, 5; 630 NW2d 383 (2001) (emphasis added).

The Court of Appeals could not have erred in "failing to recognize" something it *did* recognize. This misrepresentation is repeated as the basis of Graves' arguments. Both Graves and the RPLS incorrectly assume that the Court of Appeals failed to recognize that a land contract vendee has a *present interest in real estate*. As evidenced by the

above quoted language, this is not the case. Their arguments fail to identify that the Court of Appeals also *correctly* recognized that when the vendee's estate is created, the vendor still owns an estate in land, not merely an encumbrance on an estate in land. Their arguments conclude that, immediately upon execution of the land contract, the vendor's estate in land has converted from an estate in land to a mortgage, with the legal title securing the debt under the contract. That is not true under Michigan law. The Michigan Supreme Court has rejected such mischaracterizations of a vendor's interest under a land contract. *Detroit & Security Trust Co v Kramer,* 247 Mich 468, 226 NW 234 (1929); *Union Guardian Trust Co v Rood*, 261 Mich 188, 246 NW 74 (1933); See also *Rothenberg v Follman*, 19 Mich App 383; 172 NW2d 845 (1969), *lv den* (March 17, 1970).

D. An encumbrance is not an estate in land.

An encumbrance is substantively different and is not an estate in land under Michigan law. An estate in land has the incident right of possession; an encumbrance does not. This difference between an estate in land and an encumbrance is reflected in the relationship between a land contract vendor and vendee and the relationship between the owner of an estate in land and a mortgagee. Significantly different remedies are provided by statute to foreclose an encumbrance than to forfeit a vendee's interest under a land contract. An encumbrance must be foreclosed within strict statutory requirements. MCLA 600.3101 et seq. (judicial foreclosure) and MCLA 600.3201 et seq. (foreclosure by advertisement) The owner of an estate in land subject to foreclosure has a statutory right of redemption. MCLA 600. 5673.

On the other hand, a land contract vendee has no right of redemption, as against the vendor, because until payment, it has not yet acquired the vendor's estate in land to which such right is incident. Thus, a vendor may, if the vendee is not in possession, forfeit the vendee's rights "...without proceedings in court if notice of forfeiture is duly given". *Rothenberg* at 388. See also *Day v Lacchia*, 175 Mich App 363; 437 NW 2d 400 (1989). In fact, unless otherwise provided in a land contract, a vendee is not entitled to possession as against the vendor. *Spaulding v Wyckoff,* 320 Mich 329; 31 NW2d 71 (1948) The vendor's remedy of forfeiture is incident to its ownership of an estate in land. Unlike a mortgagee, a land contract vendor does not have to foreclose an encumbrance to obtain the estate in land because it already owns it. The arguments on appeal cannot be reconciled with the Michigan legislature's recognition of this essential difference between a vendor's estate in land and a mortgage upon an estate in land. This essential difference is reflected in the different statutory remedies and rights established between vendors and vendees and between mortgagees and mortgagors.

Graves' cite to *Rothenburg,* should be particularly noted by this Court for two reasons. Firstly, the more relevant discussion about the nature of a vendor's and a vendee's respective estates, to which the dictum is a footnote, is ignored. Secondly, although the RPLS files its Brief as Amicus Curiae, the Court should note the omission in its Brief of any reference to the frequently cited *Rothenberg* opinion. The *Rothenberg* Opinion specifically addresses the fundamental difference between the estate of a land contract vendor and that of a mortgagee as follows:

> The estate of a land contract purchaser does not (in contrast with a mortgage) include as one of its incidents an equity of redemption. This means that a land contract seller need not invoke a judicial or statutorily created remedy to foreclose the rights of the purchaser as must a mortgagee if he wishes to foreclose the mortgagor's equity of redemption.

Rothenberg, at 387-388.

The recognition by the *Rothenberg* Court of the incident rights of a vendor contradicts the argument of the RPLS that a vendor's interest is simply a mortgage. A land contract vendor simultaneously owns the fee simple estate *and* a contractual right to payment. The above cited discussion is relevant to the facts in this case, not dictum from a footnote that identifies a *similarity* between the vendor's *separate* right to payment under the land contract and a mortgagee's right to payment under a promissory note. The *Rothenberg* Court correctly identified the nature of the land contract vendee's equitable estate in land as worthy of a court's consideration in equity *when payment is made*, even if the payment is late. However, it certainly did not declare that a vendor's estate in land is a mortgage.

Based upon the same false premise that a vendor is nothing more than a mortgagee, the RPLS also argues that the equitable title is the legal title as it states:

> Just as holding title to property subject to a mortgage does not mean that an entirely new estate is created when the mortgage is paid off, the equitable title of a land contract vendee is not an entirely different estate than the estate it holds after the land contract is paid off.

(RPLS Brief at 7).

This statement is incorrect. A mortgage pay off does not change the estate of the mortgagor because a mortgage is an encumbrance, not an estate in land. The fee simple estate is absolutely an entirely different estate than the right to obtain it by payment. The land contract creates the right to obtain the fee simple estate; the deed delivered upon payment conveys the estate that is purchased. Of course, this argument directly contradicts the decisions in *Mandlebaum*, *Smith*, *Detroit & Security Trust Co, Rood*, *Rothenberg*, and *Graves*. The fee simple estate acquired after payment in full is an entirely different estate than the right to obtain the fee before actual payment. The RPLS should heed the words of the *Rothenberg* Court:

The parties cannot by use of labels convert an apple into an orange. It is the business of courts to look through form to substance. *Rothenberg* at 391.

E. The arguments on appeal advance a misapplication of the theory of "equitable conversion".

1. The arguments concerning equitable conversion were not raised in the courts below.

The RPLS has acknowledged that "...the reasoning of the Court of Appeals' decision was logical". RPLS Brief at 5. Yet, it argues for a different result. The answer to this dichotomy lies with the purpose of the RPLS supporting an Appeal to this Court. Its arguments are based upon certain members' view about the "equitable conversion" theory and a misperception of a conflict with "recent legislation". Its arguments do not speak for all of its members, many of whom disagree with these arguments. More importantly, however, the arguments conflict with prior case law and Michigan statutes that recognize the distinct difference between an estate in land and a mortgage.

Application of the equitable conversion theory in the context of these or similar facts renews confusion about the nature of a land contract vendor's interest as real estate or personal property.[1] It also adds new confusion about whether a land contract vendor

[1] The former confusion about the nature of land contract interests as real estate or personal property was addressed by the legislature after a laudable effort by members of the RPLS led by Gary Taback, Esq. The result of this effort was Act 106, PA of 1998 (the so-called "Land Contract Mortgage Act") MCLA 565.351, et seq., enacted nearly four years *after* the facts in this case occurred. See also *The "Land Contract Mortgage" – Its Brand New!*, Michigan Real Property Review, Winter 1998, p. 211. This legislation does not apply at all to the facts in this case, as it has no prospective application. *Gormley v General Motors Corp*, 125 Mich App 781; 336 NW2d 873 (1983). Nonetheless, any "conflict" is misperceived. The Court of Appeals decision is entirely consistent with its future application.

owns an estate in land or holds an encumbrance. Presently, there is no confusion under Michigan law. Both estates in land can be mortgaged, because neither estate is a mortgage. MCLA 565.351, et seq. If a fee simple estate becomes a mortgage by virtue of "equitable conversion", then a vendor, as mortgagee, has no estate in land to mortgage. A mortgage on the vendor's "mortgage" would constitute a personal property interest. The confusion would begin anew. This Court has already rejected such arguments, and the Land Contract Mortgage Act was enacted to prevent this confusion in the future.

2. Prior case law on "equitable conversion"

Graves acknowledges that:

> The Court, of course, is technically accurate *as matter of law*, in [sic] that "legal" title does not transfer until the balance of the land contract is paid off and the deed is conveyed. However, in the context of the Court of Appeals ruling, this *wrongly assumes that, until legal title is conveyed, the vendee does not have a present interest in the real property upon which creditors can rely...*

Appellant's Brief on Appeal at 13 (emphasis added).

The *right to acquire* the legal title is not equivalent to the legal title itself. The "equitable" title cannot become the legal title without the requisite act of equity. Referring to the vendor's estate *before payment by the vendee* as "mere legal title" or "security" for payment of the contract price incorrectly diminishes the significance of the legal title and elevates the "equitable" title to become the legal title itself - before payment. This is incorrect. This misunderstanding of the respective interests will always accomplish an *inequitable* result.

The vendor's separate right to payment under a land contract has been said to *resemble* a mortgagee's right to payment. However, it has never been *held* that the resemblance between a vendor's contractual right to payment and a mortgagee's right to payment actually converts a

vendor's fee simple estate into a mortgage. The RPLS cites *City of Marquette v Michigan Iron & Land Co*, 132 Mich 130; 92 NW 934 (1903) and asserts that:

> The Michigan Supreme Court has previously *held* that a land contract creates a relationship in which the vendee holds equitable title and the vendor holds legal title only, resulting in the vendor holding the equivalent of a purchase-money mortgage.

RPLS Brief at 6.

That was *not* the *ruling* of the Court. The Court ruled that the vendor's right to payments under a land contract was personal property subject to taxation. The language paraphrased by the RPLS was dictum that supported the reasoning of the Court to tax the vendor's payment. The Court did not declare a vendor's estate in land to *be* a mortgage; the Court was not considering that issue. Subsequent cases of the Supreme Court have clarified this and ruled to the contrary.

The Court in *Rood* addressed a circumstance in which a land contract vendor, John Rood, mortgaged 13 parcels of land to the Union Guardian Trust Company, including 3 parcels he had previously sold on land contract. After an attempted foreclosure of the mortgages pursuant to a "collateral sales statute", it was discovered by Union Guardian that the sale was void, and it brought a judicial foreclosure action on its mortgage. Mr. Rood agreed that the sale was void, except as to the 3 parcels sold on a land contract. Mr. Rood argued that since his mortgaged interests as a land contract vendor were properly sold as personal property under the collateral sales statute and the entire debt was bid at that sale, his entire debt to Union Trust Company was discharged at that sale as to all of the properties he mortgaged, leaving the remaining 10 parcels free from any mortgage.

In considering the Mr. Rood's arguments in which he applied the theory of "equitable conversion" of his fee simple estate to personal property, the Court stated as follows:

> If the doctrine of equitable conversion were to be applied as contended by appellant, it is obvious rather dire results would follow. For notwithstanding the doctrine of equitable conversion, the record title to the land is in the vendor (mortgagor), not in the vendee. This title can be acquired by another only by voluntary conveyance or operation of law.
>
> Of this doctrine we have recently said:
>
> *As has been pointed out by eminent authority, this theory at best is somewhat far fetched.* ... But this theory, which is no more than a legal fiction, should not be applied in such a manner or under such circumstances as will confessedly defeat the disposition that one may make of his or her property so long as such disposition is not in violation of law. ...*Carried to its logical conclusion, the doctrine of equitable conversion leads to many strange and serious results* .... *Detroit & Security Trust Co v Kramer* 247 Mich 468, 471 (1929). *Id.* at 192 (emphasis added).

Citing *Detroit & Security Trust Co*, (in which the Court held that a land contract sale did not divest the husband and wife vendors of their right of survivorship as tenants by the entireties), the *Rood* Court warned, the equitable conversion theory leads to "many strange and serious results". The *Rood* Court recognized such attempted application of the theory would "...confessedly defeat the *disposition* that one may make of his or her property...". It went on to further recognize that "[a]pplication of the doctrine of equitable conversion to the instant case would accomplish a decidedly inequitable result . . ." *Rood* at 192. Such an inequitable result would certainly occur in this case, if Graves' lien on the right to acquire the vendor's estate by payment is elevated, by application of an *equitable* theory, to a lien on the vendor's *unencumbered* estate without payment by Graves or Diaz. If American Acceptance knew about Graves' lien it would not have made the loan to Diaz, and Graves, asserting that she had a "first lien" would have prevented *acquisition* of the legal title. This Court should reject such absurdity as it did in *Rood.*

The RPLS argues:

> The crux of the Court of Appeals' decision in the *Graves* case is its conclusion that the final transfer of legal title, as opposed to the initial transfer of equitable title, is *the critical step.*

RPLS Brief at 7 (emphasis added).

The "transfer" of legal title is not the critical "step"; the critical step is *payment.* Only by payment is the "critical" element of "equity" inherent in the "equitable estate" accomplished.

3. The practical result of application of equitable conversion to the facts in this and similar cases.

Early in the history of this Court, in *Mandlebaum*, it warned against the creation of such a "mongrel estate" as Graves and the RPLS have bred, an "equitable" estate without any requirement to do equity before a fee simple estate is conveyed. They now ask this Court to allow this mongrel breed to bite off the hand that could feed it. If American Acceptance knew about Graves' lien, it would not have made the loan to Diaz. Graves' lien would have been forfeited along with Diaz' equitable estate, *unless* Graves paid the amount necessary to acquire the legal title. Graves and anyone in her position as a lien holder on the equitable title would have to pay the outstanding amount to preserve their interest. They accepted their lien on an inferior estate and have no reason to complain when the vendee obtains the fee for the same amount that they would have to pay to acquire the estate that has not yet been conveyed.

F. The purchase money mortgage doctrine is a well established, essential Michigan law.

The essence of the purchase money doctrine is fundamental fairness. As stated by this Court in *Fecteau v Fries*, 253 Mich 51; 234 NW 113 (1931):

> The rule is well stated in a note in 25 ALR, p 92, as follows:
>
> Where one who has conveyed before he had title gives a purchase-money mortgage upon acquiring the title, the cases agree that the title subsequently acquired *does not*

> *inure to the benefit of the prior grantee or mortgagee*, as against the holder of the purchase-money mortgage.

Fecteau at 54 (emphasis added).

The Fecteau facts involved two purchase money mortgages. Both mortgages were used to pay for the purchase price, but one mortgage was taken back by the seller for that portion of the purchase price not actually received from the proceeds of the other mortgage loan. The *Fecteau* Court reversed the lower court decision that held, somewhat logically, that the two mortgages were of equal priority, both being used to secure the purchase money used to acquire the fee simple estate. Nonetheless, the Court held the seller's mortgage had priority over the third-party purchase money mortgage because of the preference given to a seller purchase money mortgage over a third-party purchase money mortgage.

The *Fecteau* Court's reasoning for reversing the appellate court's decision that upheld a sharing of priority between the two purchase money mortgages is explained by a commentary to the *Restatement of Mortgages* 3d:

> The preference for vendor purchase money mortgages is arguably counterintuitive, at least from an economic perspective. After all, both the third party lender and the vendor make the sale transaction possible, and both rely upon the security of the same specific property for payment. Moreover, third party purchase money mortgagees, especially in residential transactions, often invest a substantially greater economic stake in the mortgaged property than that retained by the vendor.
>
> Nevertheless, the equities favor the vendor. Not only does the vendor part with specific real estate rather than money, but the vendor would never relinquish it all except on the understanding that the vendor will be able to use it to satisfy the obligation to pay the price.

In this case, American Acceptance is a purchase money mortgagee and Graves simply holds a prior recorded lien on a different estate in land. Without the American Acceptance mortgage loan Diaz would not have acquired the fee, as both he and Graves were in default, and

not even able to make the monthly payments, let alone the final "balloon" payment. Diaz would have lost his right to purchase it because of forfeiture by the Giordanos, and in the process Graves would have lost her lien on that right.

As the *Fecteau* Court has held, the purchase money mortgage has priority because the deed and mortgage together are one transaction, title only passes subject to the mortgage, and all other mortgages can only attach to such interest as the mortgagor acquires. *Fecteau* at 55. The *Fecteau* Court cited the applicable rule from *Dusenbury v Hulbert*, 59 NY 541 (1875) as follows:

> The deed and Bowen [American Acceptance] mortgage executed at the same time are to be construed together as one instrument. They constitute an indivisible act. There was never a moment between the seisen and mortgage when La Grange [Graves] could encumber the estate to the exclusion of the latter, and it follows that a prior mortgage could not insert itself between them.

Fecteau at 53.

In *Hammel v First National Bank of Hancock*, 129 Mich 176; 88 NW 397 (1901) this Court also held that when a sale and mortgage are concurrent they constitute one transaction and therefore a prior recorded mortgage covering after-acquired property cannot obtain title free from the purchase money mortgage used to acquire it. The *Hammel* court, above, and the *Fecteau* court both cited *US v New Orleans & O R Co,* 79 US 362 (1870) and, addressing the very arguments put forth by Graves as to her prior recorded lien in this case, stated:

> A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor's hands. If that property is already subject to mortgages or other liens, the general mortgage does not displace them, though they may be junior to it in point of time. It only attaches to such interest as the mortgagor acquires; and, if he purchase property and give a mortgage for the purchase money, the deed which he receives and the mortgage which he gives are regarded as one transaction, and no general lien impending over him, whether in the shape of a general mortgage, or judgment, or recognizance, can displace such mortgage for purchase money.

Hammel at 177; *Fecteau,* at 54, citing *US v New Orleans & O R Co,* at 365.

As noted by the Court of Appeals below in *Graves*:

> Michigan courts have regarded *any* mortgage whose proceeds were used to acquire title to property as a purchase money mortgage, regardless of whether the vendor or a third party such as a financial institution is the mortgagee. *Van Stee v Ransford*, 346 Mich 116, 119; 77 NW2d 346 (1956); *Rossman v Marsh*, 287 Mich 580, 582; 283 NW 696 (1939), *aff'd on reh'g* 287 Mich 720; 286 NW 83 (1939). See also Restatement Property, Mortgages, 3d, § 7.2, p 458, defining "purchase money mortgage" as including "a mortgage given to a vendor of the real estate or to a third party lender to the extent that the proceeds of the loan are used to acquire title to the real estate."

Graves, at 5 (emphasis added).

The Court should be troubled by the "argument" from the RPLS that "only seller financing is entitled to purchase money super-priority". This argument contradicts the Michigan legislature's recognition of purchase money mortgage status to third-party lenders in MCLA 600.6023. It also contradicts its own commentary to The Michigan Land Title Standards, promulgated by the RPLS, that "[a] mortgage is a purchase money mortgage if the proceeds are used to acquire the title, *regardless of whether the vendor is the mortgagee.*" *Michigan Land Title Standards* 4.5, 5.3, and 20.2 (problem H) (emphasis added).

The *Fecteau* opinion is particularly applicable and instructive to these facts because it was based upon *both* the *applicability* of the purchase money mortgage doctrine *and* the *inapplicability* of the recording acts to prior recorded liens against the "same real estate or portion thereof". MCLA 565.29. The meaningless distinctions made by Graves and the RPLS between the facts in *Fecteau* and those in this case ignore the essence of this precedent and the reason and fundamental fairness underlying the purchase money mortgage doctrine and the Michigan recording statutes.

Even more relevant and instructive to this Court is the reasoning in the decisions cited by the Court of Appeals in *Graves* from two other race-notice states, Indiana and Illinois, that were based upon facts in similar circumstances to those here involved. This reasoning is incontrovertible support for the decision below, particularly in light of Graves' and the RPLS's erroneous premise that the "special status" of land contracts in Michigan equates to the fee simple estate, upon the vendor's execution of the land contract, immediately changing into nothing more than a mortgage. *Liberty Parts Warehouse, Inc v Marshall Co Bank & Trust*, 459 NE2d 738 (Ind App, 1984); *Wermes v McCowan*, 286 Ill App 381; 3 NE2d 720 (1936).

After recognizing that the liens attached to the equitable interest of the vendee, the *Wermes* court, *supra*, reasoned as follows:

> [H]owever their [Graves] rights under their liens [Graves' lien] would have been no greater than McGowan's [Diaz'] rights under the sales contract. The only interest or right that McGowan [Diaz] had under such contract was the equitable right to enforce the same providing he had performed it on his part. Thus we see that appellants [Graves], under such a lien, would find the same subject to the payment of the unpaid purchase price upon said lot. Until payment of the purchase price, it is manifest that specific performance could not be had. Therefore, appellants [Graves] rights are in no way impaired or injured.

Id. at 721 -722.

Although the "refinance" argument was not made by Graves in the court below, the Court of Appeals in *Graves* did note that the argument was made in *Liberty Parts* and rejected it, agreeing with the reasoning and the decision as follows:

> A purchase money mortgage is one which is given as security for a loan, the proceeds of which are used by the mortgagor to acquire legal title to the real estate. When the deed and mortgage are executed as part of the same transaction the purchaser does not obtain title to the property and then grant the mortgage; rather, he is deemed to take the title already charged with the encumbrance. Because there is no moment at which the judgment lien can attach to the property before the mortgage of one who advances purchase money, the prior judgment lien is junior to the purchase money mortgage.

Regarding the unreasoned conclusions in the New Mexico and Oregon decisions that a payoff of a land contract is simply a refinance, the Court of Appeals in *Graves* below correctly observed as follows:

> To the extent that these cases stand for the proposition that no mortgage whose proceeds satisfy the mortgagor's obligation to his land contract vendee can qualify as a purchase money mortgage, we decline to follow these cases because we find that the New Mexico and Oregon courts failed to (1) recognize the significant fact that only through the mortgages did the land contract vendees obtain legal title to the properties, and (2) appropriately consider or weigh in their decisions the public policies behind affording purchase money mortgages priority over the earlier lienholders' interests.

C & L Lumber & Supply, Inc v Texas American Bank/Galeria, 110 NM 291, 296; 795 P2d 502 (1990). This case is particularly inapposite to an analysis of these facts because the subsequent mortgage at issue was only one half of the amount necessary to payoff of the land contract and obtain the legal title. Thus the mortgage was only in part a purchase money mortgage. Nonetheless, in its Opinion, the New Mexico Court simply ignored this fact without discussion. In *Lorenz Co v Gray*, 136 Or 605, 615; 298 P 222 (1931), the Oregon Court ignored the fact that the legal title was only obtained with the purchase money mortgage proceeds, providing no reason for its conclusion whatsoever.

A purchase money mortgage is a mortgage executed to secure funds used to purchase an interest in real estate. 1 John G. Cameron, Jr., *Michigan Real Property Law* (2d ed 1995) §18.13 at 673; *Michigan Land Title Standards* 4.5, 5.3 and 20.2. Diaz received the fee simple estate in the property simultaneously with, and subject to, the mortgage held by American Acceptance. The entire loan proceeds for which the American Acceptance mortgage was security were used by Diaz to purchase the fee simple estate. Diaz did not encumber any of his equity interest with

the purchase money mortgage, because the entire mortgage proceeds were required to obtain the fee. Graves' lien could not possibly have attached to Diaz' *unencumbered* fee simple estate, prior to the American Acceptance mortgage, because Diaz never owned an unencumbered fee simple estate. When, after Graves recorded her lien, Diaz acquired the fee simple title, Graves' lien could only have attached to whatever interest Diaz obtained from the Giordanos. This fee simple estate was, as a matter of law, already subject to American Acceptance's purchase money mortgage.

The Court should also take note of the *Restatement Property, Mortgages* 3d promulgated by the American Law Institute and its comprehensive analysis and well-reasoned conclusion that the purchase money mortgage doctrine applies to all mortgages used to acquire a real estate interest, whether or not they are provided by the seller of the property or by a third-party lender. All of the examples and reasoning set forth in the *Restatement Property, Mortgages* 3d support the conclusion reached by the Court of Appeals below.

Michigan law is long-established and well-reasoned that purchase money mortgages must be afforded priority over prior recorded liens against the same real estate interest to the extent that the proceeds of such mortgages are the very means to acquire it. Nonetheless, the RPLS states as follows:

> [I]t is not clear that the concept of purchase-money *super-priority* remains a viable concept. However, to the extent that it survives, an argument can be made that only seller financing is entitled to purchase money *super-priority*.

RPLS Amicus Brief at 11 (emphasis added).

It should be noted by the Court that both Graves and the RPLS have used the inarticulate and wholly inaccurate term "super-priority"; American Acceptance has not. The "super" priority relates only to prior, not subsequent, purchasers, of the "same real estate interest". MCLA

565.29. Quite contrary to the argument of the RPLS, that purchase-money mortgage status is no longer "a viable concept" and should be limited to vendor mortgages, these mortgages are the primary means of acquiring real estate. The Court of Appeals below properly considered both the fundamental fairness and public policy reasons recognizing the priority of purchase money mortgages:

> Because third party lending is the dominant source of purchase money land financing in this country, a rule which facilitates such lending is especially beneficial to the national real estate economy. Applying the rule to benefit third party lenders is plainly fair. While it is true that such lenders, unlike vendors, do not give up ownership of specific real estate, they nevertheless part with money with the expectation that they will have security in that real estate. Without this advance of money, the purchaser-mortgagor would never have received the property and the other claimants would never have had the opportunity to satisfy their claims from such a convenient source. As in the vendor purchase money context, this section seeks to avoid conferring a windfall on those claimants.

Restatement Property, Mortgages, 3d, § 7.2, comment b, p 460.

There can be no question about whether this legal doctrine remains "a viable concept". A judicial death knell to the priority of purchase money mortgages over prior recorded liens would not only be an economic disaster, but it would be entirely *inconsistent* with a correct application of the recording statutes that Graves attempts to subvert. Such a decision would substantially impair the ability of borrowers to obtain financing. It would cause extremely unfair and illogical results upon parties who may have an opportunity to obtain a real estate interest but, because they are subject to prior recorded tax liens, or prior recorded mortgages encumbering after-acquired real estate interests, would be denied that opportunity. This Court has previously held in *Dolby v State Highway Commissioner,* 283 Mich 609; 274 NW 694 (1938), that "a rule of property ought not to be overturned without the very best of reasons." The purchase money mortgage doctrine has been and must remain the law in Michigan simply because it is fair.

II. THE COURT OF APPEALS CORRECTLY RULED THAT MICHIGAN RECORDING LAWS DO NOT APPLY WHEN A PRIOR RECORDED LIEN AGAINST A LAND CONTRACT VENDEE'S EQUITABLE TITLE BECOMES SUBJECT TO A SUBSEQUENT PURCHASE MONEY MORTGAGE WHOSE PROCEEDS ARE USED BY THE VENDEE TO ACQUIRE THE LEGAL TITLE.

A. MCLA 565.29 is inapplicable to Graves' lien.

1. Graves is a prior purchaser who is not "protected" under the race-notice provision contained in MCLA 565.29.

Graves' frames her first issue on appeal as follows:

> DID THE COURT OF APPEALS ERR IN GIVING PRIORITY TO A MORTGAGE, THE PROCEEEDS OF WHICH WERE USED TO PAY OFF THE BALANCE OF A LAND CONTRACT, OVER A PRE-EXISTING, RECORDED LIEN?

Graves Brief on Appeal at vii.

This question omits the most relevant facts in this case: 1) that the equitable title to which the lien attached was *not* the same as the after-acquired legal title, and; 2) that upon acquisition of the legal title by Diaz, Graves' lien could only attach to the legal tile subject to the purchase money mortgage of American Acceptance. Graves argues that "[t]he recording statutes in the State of Michigan fail to provide a super-priority or special consideration to purchase money mortgages relative to other prior recorded instruments" Graves' Brief at 4. The argument misstates the clear legislative intent to protect *subsequent* purchasers. The Court has previously rejected this argument because "[t]hese laws are intended for the protection of *subsequent*, not prior, purchasers and creditors." *Fecteau* at 54, citing *New Orleans & O R Co* at 365 (emphasis added).

Since this Court has already held that the recording statutes do not apply to such a cases now before it, there is no reason for the legislature to "provide a super-priority or special

consideration" for purchase money mortgages within the *inapplicable* recording statutes. The special consideration given to purchase money mortgages derives from their very nature of providing property to a debtor's estate that it would not otherwise have acquired. The doctrine has already been well established by numerous prior decisions of this Court. In fact, as already noted, in MCLA 558.4 (relating to dower interests) and MCLA 600.6023 (relating to homestead interests), the Michigan legislature has assured recognition of the priority of *all* purchase money mortgages even over these interests of historically special concern.

The purchase money mortgage doctrine functions independently of the recording statutes because the recording statutes serve to protect subsequent purchasers. Their purpose is to provide a mechanism for subsequent purchasers of the same real estate interest to protect themselves. Like the purchase money mortgage doctrine, the recording statutes in Michigan serve to assure fundamental fairness. The result sought by Graves is repugnant to fairness. Citing the inapplicable recording statutes to pursue that result distorts their purpose. The recording statutes are essential to the acquisition and protection of real estate interests. An extremely careful reading of them is demanded to assure they are applied to the circumstances intended by the legislature, and not being misapplied to accomplish an unfair result.

After its surprising suggestion that application of the purchase money mortgage doctrine should limited to vendor mortgages, the RPLS offers this misstatement of Michigan's recording laws:

> Giving a mortgage priority over previously recorded encumbrances is difficult to reconcile with the statutory concept that, *as a general rule, priority between encumbrances of real estate interests is based solely on order of recording.*

RPLS Amicus Brief at 11 (emphasis added).

This statement is contrary to the recording laws in Michigan. Explaining the purpose and intent of the recording statutes, it has been observed that:

> Because of the need to protect persons who might be innocent purchasers of real estate that was the subject of a prior conveyance and to make land titles public information, the common-law rule of first in time is first in right has been modified by the enactment of recording acts.

1 John G. Cameron, Jr., *Michigan Real Property Law* (2d ed 1995) § 11.18 at 374.

A careless reading of these statutes lends itself to muddled references to a "general rule under Michigan's "race-notice" recording statute". Graves' Brief at 3. There is no "general rule" under this statute. MCLA 565.29 *specifically* provides:

> **Unrecorded conveyance, validity against subsequent purchaser; relation of quit claim deed to good faith.**
>
> Sec. 29. Every conveyance of real estate within the state hereafter made, which shall not be recorded as provided in this chapter, shall be void as against *any subsequent purchaser in good faith and for a valuable consideration, of the same real estate or any portion thereof, whose conveyance shall be first duly recorded.* The fact that such first recorded conveyance is in the form of a deed of quit-claim and release shall not affect the question of good faith of such subsequent purchaser, or be of itself notice to him of any unrecorded conveyance of the same real estate or any part thereof (emphasis added).

This statute supplants the "general" common law rule of "first in time is first in right". If a party seeking to establish priority under this provision is not a *subsequent* purchaser, as Graves is not, then the recording laws simply do not apply. In other words, her lien was recorded prior to acquisition of the legal title by Diaz, so as to that interest, Graves is a *prior* purchaser. The term *purchaser* is defined in MCLA 565.34:

> The term "purchaser," as used in this chapter, shall be construed to embrace every person to whom any estate or interest in real estate, shall be conveyed for a valuable consideration, and also every assignee of a mortgage, or lease, or other conditional estate.

A *mortgagee* is a purchaser. *Lowry v Lyle*, 226 Mich 676, 198 NW 245 (1924). A conveyance includes a mortgage. *Stover v Bryant & Detwiler Improvement Corp*, 329 Mich 482, 45 NW2d 364 (1951); *Michigan Fire & Marine Insurance Co v Hamilton*, 284 Mich 417, 279 NW 884 (1938).

Within MCLA 565.35, the legislature has specifically recognized the many possible and different estates in land in:

> The term "conveyance" as used in this chapter, shall be construed to embrace every instrument in writing, by which *any estate or interest in real estate* is created, aliened, mortgaged or assigned, or by which the title to any real estate may be affected in law or equity, except wills, leases for a term not exceeding 3 years, and executory contracts for the sale or purchase of lands. (emphasis added).

Careful consideration of the different estates or interests in land is absolutely essential to a proper analysis of priority issues, as exist in this case. Graves and the RPLS fail to identify these different estates or interests; they also fail to appreciate the operation of the recording system, particularly the grantor-grantee indexing system established under MCLA 565.28.

Each of the elements contained in MCLA 565.29 that define a protected subsequent purchaser must be evaluated. In this case particularly, the Court must also determine whether the competing lien interests encumber "...the *same real estate* or any portion thereof..." MCLA 565.29 (emphasis added). The cited language in MCLA 565.35 and in MCLA 565.29 addresses the relative priorities of parties simultaneously owning different real estate interests or holding encumbrances on those different interests in the same parcel of land. In this case, as to the legal title, Graves was not a protected *subsequent* purchaser under MCLA 565.29, because Diaz did not own the legal title when Graves recorded her lien. As discussed, Graves and the RPLS's use of the theory of "equitable conversion" cannot result in Diaz being entitled to the legal title before payment in full of the land contract.

The legislature intended to protect only subsequent purchasers because these are the only purchasers that rely on the real estate records to determine the status of the real estate interest they seek to purchase. Prior recorded lien claimants of after-acquired real estate interests, such as Graves, do not *rely* upon an estate or interest being owned at the time they obtain or record their liens. They are not protected parties, because they do not purchase a specific interest *in good faith and for a valuable consideration.* They also can *never be* in the record chain of title, having recorded their interests prior to the conveyance to the after-acquiring purchaser.

2. MCLA 565.25 does not relate to a "perfection" of Graves' lien.

MCLA 565.25 (in effect in 1994, as it has since been amended) reads as follows:

> **565.25. Entries; effect as notice.**
>
> In the entry book of deeds, the register shall enter all deeds of conveyances absolute in their terms, and not intended as mortgages or securities, and all copies left as cautions, and in the entry book of mortgages he shall enter all mortgages and other deeds intended as securities, and all assignments of any such mortgages or securities; and in the entry book of levies he shall enter all levies, attachments, notices, or lis pendens, sheriffs' certificates of sale, and United States marshals' certificates of sale, noting in such books the day, hour and minute of the reception and other particulars, in the appropriate columns in the order in which such instruments are respectively received, and every such instrument shall be considered as recorded at the time so noted. And the record of such levies, attachments, notices, lis pendens, sheriffs' certificates, marshals' certificates, and the original papers *required by statute to be recorded* to perfect such levies, attachments, notices, lis pendens, and certificates on record in the office of the register of deeds, shall be notice of the liens, rights and interests acquired by or involve in such proceedings, and all *subsequent owners or incumbrances* shall take subject to such liens rights or interests. (Emphasis added).

Graves cites a fragment of the foregoing provision and offers this argument to the Court:

> Additionally, at the time Graves recorded her lien, MCL 565.25, MSA 26.543 stated that, once an instrument has been perfected (i.e., properly recorded), "in the office of the register of deeds...*all subsequent owners or encumbrances* (sic) *shall take subject to the perfected liens, rights or interests.*"

Graves' Brief on Appeal at 3 (emphasis added).

This statement reflects a dangerous misreading of this provision and its intended purpose. MCLA 565.25 does two things: 1) it establishes and requires the county registers of deeds to maintain "entry books", and; 2) it identifies the means by which certain "liens, rights and interests are in fact *perfected* by recording them, *if* such lien, right or interest is required "by statute" to be recorded in order to be perfected. Reading this cited phrase outside the context of the entire sentence subverts the undisputed intent of the legislature under MCLA 565.29 to create a *race-notice* statute, and create a direct conflict between these provisions. Such a reading of the phrase, by itself, appears to revert to the common law "first in time is first in right" rule. The language must be read within the entire sentence in the entire context of the provision. Graves' lien is not a lien that was "...required by statute..." to be recorded to perfect it, so the cited provision has no relevance to her lien at all. Her lien was valid against Diaz with or without recording. Graves was required to record in order to prevent her lien on Diaz vendee's interest from being rendered void as against a "subsequent purchaser in good faith ... of the *same real estate*". Finally, since Graves has created the confusion, it should be clarified that except for those interests that may be required by "any other statute" to be recorded to be perfected, the recording statutes are not "perfection" statutes, and it is inaccurate to refer to them as such. (See Graves' Brief at 3, in which Graves recites "once an instrument has been perfected (i.e., properly recorded)". This reference is inaccurate and leads to a common misunderstanding about the purpose of the recording laws. They are *not* intended to be "perfection" statutes.

3. Since Graves' lien was not discoverable by American Acceptance, it could not have provided *any* constructive notice, even of her inferior lien against Diaz' vendee's interest.

Regardless of the fact that Diaz' interest and Graves' lien on that interest was a different and lesser estate in land than the fee simple estate, the recorded lien did not provide any constructive notice of its existence at all because it was not discoverable by American Acceptance. Pursuant to the specific language of MCLA 565.29, it is not enough that a "conveyance" be "recorded"; it must "...be recorded as provided in this *chapter*". (emphasis added) MCLA 565.29. This language encompasses the indexing system established under MCLA 565.28, the so-called grantor-grantee index, through which subsequent purchasers can discover and protect themselves against prior interests in "...the same real estate or portion thereof". This indexing system is supplemented to the current "day, hour and minute" by the "entry books" established and required to be maintained by all county registers of deeds pursuant to MCLA 565.25.

Despite the foregoing statutory mandate contained in MCLA 565.25, the Oakland County Register of Deeds and numerous other county registers of deeds have ceased to maintain entry books. Thus, there exists, contrary to statute, a "gap period", during which time a subsequent purchaser is unable to search the records to "...the day, hour and minute..." as contemplated by the legislature. It was during this "gap period", the morning of the scheduled mortgage closing, that Graves recorded the judgment creating her lien against Diaz' equitable title. The lien could not possibly have been discovered before the mortgage closing, because the index was considerably dated and there was no entry book.

The failure or inability of a register of deeds' office to perform its statutory obligation and provide an accurate and current index *and* entry book is a problem for *prior* purchasers who

must provide constructive notice to subsequent purchasers, or their interests will be void as to such subsequent purchaser defined in MCLA 565.29. If an interest is recorded with the register of deeds, but, because of the register of deeds' failure to properly or currently index the interest in the record chain of title as required by MCLA 565.28, and to maintain the entry book required by MCLA 565.25 so a subsequent purchaser can search title to the current "day, hour and minute", such prior interest cannot be discovered. Any resulting loss must be borne by the prior party who has failed to provide constructive notice. *Gordon v Constantine Hydraulic Co,* 117 Mich 620, 76 NW 142 (1898); *Barnard v Campau*, 29 Mich 162 (1874); *Heim v Ellis*, 49 Mich 241, 13 NW 582 (1882). This result is mandated by MCLA 565.29 that specifically provides that:

> Every conveyance of real estate within the state hereafter made, *which shall not be recorded as provided in this chapter*, shall be void as against any subsequent purchaser.... (emphasis added).

The basis of the results in the above-cited cases is the intent of the legislature to protect subsequent purchasers. Only the prior purchaser could do something about the lack of notice, even though it may have been a clerical error. The lack of an entry book poses a much larger issue than these individual cases.

Although perhaps one of the many reasons why Graves' lien went undiscovered, the registers of deeds' failure to maintain entry books is not the determinative factor in this case, and the Court should not decide this case on that basis. The Court can expect better focus on the lack of an entry book issue in the case of *Central Ceiling & Partition v Dep't of Commerce*, 249 Mich App 438; 642 NW2d 397 (2002) (leave to appeal granted March 26, 2003) (where a challenge to perfection of construction liens is made based upon the failure of the register of deeds to index the liens within the 90 day period required to record a lien under the Construction Lien Act).

The Court must not allow Graves' individual subversion of the recording system in this case, where the recording laws are inapplicable, to result in less than a complete analysis of the issue looming in *Central Ceiling*. A determination that the "gap" means interests are not recorded at all until indexed, as may be concluded by the language in MCLA 565.29 ("...which shall not be recorded as provided in this chapter...") would create mass confusion and have disastrous effects on the race-notice recording system in Michigan. In large counties the "gap" between presentment of a document for recording and indexing is sometimes months. The Court simply *cannot* declare that this breakdown of the system affects innocent parties who diligently and timely record their real estate interests. To reach this result would reek havoc among parties competing for priority after they are left to do so by someone who has taken advantage of the system breakdown.[2] This case does not require such a determination. A ruling in favor of American Acceptance in this case is mandated by the law cited by the Court of Appeals below, i.e., the *inapplicability* of the recording statutes and the *applicability* of the purchase money mortgage doctrine.

4. Graves' recorded lien never entered any chain of title.

As a Realtor in Oakland County, and land contract purchaser of several rental properties in the Pontiac, Michigan area (as evidenced by the Judgment creating her lien at issue in this case), Graves was undoubtedly aware of the need to record her interests in these properties. Nonetheless, for seven years, after they first entered into a land contract with the Giordanos on August 25, 1987, neither Diaz nor Graves had recorded their land contract on 72 West End. After

[2] Mortgagees would be left floundering with no means whatsoever of "recording" within the very short time frames set forth in Section 547 of the bankruptcy code, and thereby protecting themselves from the risk of a borrower bankruptcy within 90 days of the indexing in the grantor-grantee index. Certainly, neither side to this dispute would support such a result.

their divorce in early June, 1994, Graves also failed to record the Consent Judgment of Divorce that created the lien, until the morning of September 7, 1994 at 8:54 a.m. Graves knew that Diaz was closing later that day on a mortgage he procured to pay off the land contract and acquire the legal title. At the time of that recording, however, Graves' lien was outside the record chain of title because neither she nor Diaz had recorded the land contract. Neither Graves nor Diaz had a recorded interest discoverable by a search of the grantor-grantee index. The Giordanos were the owners in fee simple and the record title ended with them.

Even if Graves' lien had been recorded timely *and* it was discovered, *and* American Acceptance proceeded to close with Diaz, American Acceptance would still prevail in this case, for the same reasons previously discussed regarding the purchase money mortgage doctrine. Separate record chains of title may exist for the numerous possible simultaneously held estates or interests in land. Several tenants in common with undivided fractional interests may own a parcel of land. Each interest may be conveyed independently of the other and create its own chain of title. Mineral rights may be conveyed by deed and create a new chain of title as to that interest. A leasehold interest may be assigned or mortgaged and create a separate chain of title as to that interest. Prior to payment for the legal title, a vendee's equitable interest may be conveyed, as the Court of Appeals *did* recognize. A vendor can likewise convey its fee simple estate, subject to the rights of the vendee to acquire it by payment. As is now recognized under the Land Contract Mortgage Act, a land contract vendee's interest may be conveyed to one mortgagee, while the vendor's interest is conveyed to another mortgagee. MCLA 565.351 et seq.

The RPLS confuses the facts concerning the record "chain of title". The RPLS states:

> MLTA argues that the Divorce Order is deficient and is not entitled to the benefit of the priority established through the recording statutes because the Divorce Order was recorded before the deed to Diaz, and thus was outside the chain of title. However, if that argument is correct, *the Mortgage is also not entitled to the*

benefit of MCL 565.29 because the Mortgage is similarly outside the chain of title.

RPLS Brief at 8 (emphasis added).

This statement is incorrect for several reasons. Graves could not have provided *any* notice, actual or constructive, to subject American Acceptance's mortgage to her lien. She had no lien against the legal title, because Diaz did not own it. As of the date of the American Acceptance Mortgage closing, the Giordonos owned the legal title, and they were the last grantees in the record chain of title to that estate. Graves' did not record her lien in the record chain of title of either interest, the initial equitable title *or* the after-acquired legal title. As discussed, the purchase money mortgage doctrine has been adopted under Michigan case law, and the recording laws do not apply to prior purchasers. Graves' prior recorded lien against Diaz' after-acquired legal title was not in the record chain of title of either interest, because, as to the legal title, it was recorded before the date of the deed to Diaz *and,* as to the equitable title, Graves had failed to record the land contract. A search of the chain of title runs from the Giordonos to Diaz by deed dated September 13, 1994. After the *date* of that recorded deed the next recorded instrument is the mortgage to American Acceptance. The deed conveyed to Diaz the legal title already subject to the American Acceptance Mortgage used to acquire it. As to Diaz, in equity, Graves could still assert her lien on Diaz' interest, but not as to American Acceptance, a subsequent purchaser protected under MCL 565.29. A subsequent purchaser is only put on constructive notice of those matters lying within the *record chain of title,* established under MCL 565.28, to "the *same real estate* or portion thereof" MCL 565.29. Thus, Graves' lien was outside the record chain of title, as a matter of law. There is no constructive notice to *subsequent* purchasers of matters outside the record chain of title. *Meacham v Blaess,* 141 Mich 258; 104 NW 579 (1905); *Stead v Grosfield*, 67 Mich 289; 34 NW 871 (1887). Of the failure to

record a prior interest within the record chain of title to enable subsequent purchasers to discover it, the Court in *Stead* has stated, "our recording law, so far as notice is concerned, would prove a snare, instead of protection to innocent parties".

Whether American Acceptance's mortgage was recorded *at all* is irrelevant to Graves' *prior* recorded lien. American Acceptance is the subsequent purchaser in this case, not Graves. Once American Acceptance became a protected subsequent purchaser as to Graves, recording its mortgage made no difference as to her. As the Court in *Fecteau* stated when the same issue was raised by the prior purchaser in that case, "...in such cases a failure to register the mortgage for purchase money makes no difference." *Fecteau* at 54. The recording of the American Acceptance Mortgage in the chain of title was relevant only to subsequent purchasers from Diaz, i.e. to provide those subsequent purchasers notice of the mortgage. American Acceptance did record its mortgage after the date of the deed, so in fact, it was discoverable by "running" the record chain of title.

Since Graves' lien was undiscoverable in any index, because it was not yet indexed and there was no entry book, discussion of the separately maintained tract index in Oakland County is moot. It should be noted however, that although many registers of deeds maintain a tract index, a tract index does not provide constructive notice of anything, because MCL 565.28 establishes the only official index capable of providing constructive notice – the grantor-grantee index - that creates the "chain of title". *John Widdicomb Co v Card*, 218 Mich 72 (1922).

5. There were no facts involving Diaz that would give rise to any inquiry.

Graves, as an original vendee on the contract, knew the balance was due and that she and Diaz were in default, as the final "balloon payment" was due on August 25, 1994. The title company retained by American Acceptance conducted a search of *both* the grantor-grantee and

tract indexes maintained by the Oakland County Register of Deeds' office. The records revealed no interest of Graves (then Eileen Pretto) or Diaz in 72 West End. Diaz was unable to produce a copy of the land contract prior to, or at, the closing. A copy of the contract itself was irrelevant, however, because the Giordanos were conveying the legal title to Diaz. A copy of the Deed is included in Appellee's Appendix at 4b. The Giordanos provided a payoff letter to American Acceptance reflecting the payoff of the contract with Steve Diaz. Neither the name Graves nor Pretto were reflected on the payoff letter. Appellee Appendix 2b. Prior to the closing, the title was "updated", both indexes were searched in the Oakland County Register of Deeds' office and the records again revealed nothing about Diaz, Graves, Pretto, or a judgment lien.

Finally, at closing, Diaz executed an affidavit in which he represented that there were no liens (recorded or unrecorded) against his interest. Appellee Appendix 3b. The Warranty Deed provided to Diaz reflected nothing about Graves. It merely contained an exception for "acts and omissions of the Grantee since 8-25-87 being the date of a certain land contract pursuant to which this deed is given. There was nothing more that American Acceptance could have done to discover Graves' lien. None of the documents relevant to the mortgage closing and acquisition of title by Diaz reflected anything about Graves. *Kastle v Clemons*, 330 Mich 28, 31; 46 NW2d 450 (1950) provides guidance for this duty of inquiry:

> When a person has knowledge of such facts as would lead any honest man, using ordinary caution, to make further inquiries concerning the possible rights of another in real estate, *and fails to make them*, he is chargeable with notice of what such inquiries and the exercise of ordinary caution *would have disclosed.*

The absence of "such facts" relieved American Acceptance of any further inquiry. What more could it do, refuse to close until Diaz produced a copy of the land contract that was being paid off? The suggestions that American Acceptance should have discovered Graves, under these

circumstances, when she stayed so well hidden, are rather duplicitous. Graves should have recorded the land contract and the lien without delay. Her lien would have been discovered, and American Acceptance would not have provided the loan. Graves and Diaz would have been forfeited and there would not have been this lawsuit. It is patently unfair to suggest that American Acceptance should have discovered her when she did everything possible to keep her lien hidden from it until they became a protected subsequent purchaser under MCL 565.29.

6. Legislation concerning Land Contract Mortgage Act and Future Advance Mortgages are unaffected by this case or similar facts.

a. Future Advance Mortgages.

Mortgagees securing future advances have no basis in reason or the recording statutes to claim priority over a subsequent purchase money mortgage whose proceeds are used directly for acquisition of a particular real estate interest and thereby bring new value to a mortgagor. The same rationale applies to these mortgages as to any other prior recorded lien or encumbrance. The RPLS's arguments to the contrary conflict with the functioning of the grantor-grantee indexing system because any subsequent purchaser would be required to search a grantee's name *before* they are in the chain of title. The result argued for would also result in a *potential* purchaser of a newly acquired real estate interest, such as the purchaser of legal title, being left at the mercy of the future advance mortgagee to either subordinate its mortgage to a purchase money mortgage, become the purchase money lender itself, or do nothing and cause the potential grantee/borrower to lose their opportunity to purchase. All of these options are negative and cause potential acquisition of the real estate interest to be lost. Borrowing choices to acquire new real estate interests would be extremely limited. Borrowers would have a status with their mortgages similar to indentured servants. The Court should shun such a conclusion that would effectively create a new and even more unacceptable restraint on alienation that might more

precisely be described as a restraint on "acquisition" with obvious deleterious effects on the economy.

Closer to the issues in this case, however, is the fact that the recording statutes create a reasonable and practical means of determining the status of title of the real estate interest being mortgaged by searching only the register of deeds grantor-grantee index established under MCLA 565.28. A search of this index that creates the "record chain of title", by its very nature, excludes any search of the prospective grantee/purchase money mortgagee's name, since that party is not yet in the chain of title. The arguments that a mortgage containing a dragnet clause encompassing after-acquired property or a future advance mortgage should have priority over a purchase money mortgage simply because of a prior recorded mortgage that lies outside the chain of title would destroy the legislatively established recording system. Subsequent purchase money mortgagees need not search the register of deeds grantor-grantee index for such prior liens or mortgages *because* they lie outside the record chain of title established under MCLA 565.28, and because the prior encumbrancers are not protected subsequent purchasers under MCLA 565.29.

b. Land Contract Mortgages

The arguments that the purchase money mortgage doctrine emasculates the Land Contract Mortgage Act are without merit. There can be no "bargained for priority" (RPLS's Brief at 6) as to any greater interest than the vendee owns at the time a land contract mortgage is taken on that vendee's interest. This misperceived conflict between the Court of Appeals' decision and the Land Contract Mortgage Act is wholly based upon the previously discussed and misapplied theory of "equitable conversion".

The RPLS has it backwards. It is not the Court of Appeals' "logical" decision that fails to recognize "the special status of land contracts in Michigan"; it is the RPLS that is doing so. Ironically, although purporting to defend it, the arguments of the RPLS advance toward a judicial abolishment of the land contract in Michigan, because it ignores the fact that the estate in land owned by the vendor is *not conveyed* to the vendee *until payment*.

The example contained on page 20 of Graves' Brief is irrelevant. This example reflects the confusion arising from misapplication of "equitable conversion" and the basic fallacy in the arguments on appeal. The vendor's interest is not a mortgage. Since a lien claimant against a vendee's interest or a mortgagee of a land contract vendee's interest has either actual, constructive, or inquiry knowledge of the *exact* amount necessary to pay the contract in full and obtain the legal title, they cannot have relied upon any greater "bargained for priority" than being subject to the outstanding purchase price. This example also reflects Graves' failure to appreciate that there was no prejudice to her lien interest, and there can never be "prejudice" to a such a prior recorded lien claimant or mortgagee of a vendee's interest when it becomes subject to a purchase money mortgage used to acquire the legal title. The amount of the land contract payoff is a fixed amount. It has to be paid to the vendor to acquire legal title regardless of the appreciation or depreciation in the property. The amount of the purchase money mortgage having priority over a prior recorded lien against that vendee's interest will only be the amount necessary to acquire the legal title because only that amount can constitute purchase money loan proceeds.

Thus it has been long-established, based upon fundamental fairness, that, as a matter of law, such prior recorded lien claimant or mortgagee is subject to a subsequent purchase money mortgage to the extent that its proceeds acquired a new and greater estate in land than that owned

by the vendee when the prior lien or mortgage attached. All of the payments made on the land contract that have reduced the amount necessary to pay the land contract in full and obtain the legal title inure to the benefit of the prior lien claimant or mortgagee because they reduce the amount of a purchase money mortgage. By operation of the purchase money mortgage doctrine and the recording statutes, the prior lien claimant or mortgagee simply does not get a windfall of the unencumbered legal title when purchase money mortgage proceeds are used to vest legal title in the vendee.

As noted, this particular case does not involve a mortgage for more than the amount need to pay the purchase price in full and acquire the legal title. So Graves was not prejudiced in any way. In such other case, any proceeds of a mortgage exceeding the amount needed to acquire the legal title would not be purchase money mortgage proceeds, and the purchase money mortgage would not have priority over the prior lien or mortgage to that extent, if it had either actual or constructive notice "recorded as provided in this chapter." MCLA 565.29.

In order to pay off the land contract balance when it comes due, the choices of the vendee and its mortgagee are these: 1) The vendee pays the land contract from its own available funds. In this case the vendee becomes a mortgagee of the fee simple estate. There is no problem, the mortgagee's security is enhanced by the increased equity of the former vendee, now legal title holder, or; 2) the vendor can convey the legal title and take back a second mortgage for the balance of the purchase price. According to the arguments on appeal, since the vendor holds *mere* legal title that is really an *equitable mortgage* by *conversion*, it would be second in priority to the vendee's mortgagee (it is rather unlikely the vendor would agree to do that), or; 3) the vendee's mortgagee makes an additional loan to the vendee and becomes the mortgagee of the former vendee, now legal title holder, or; 4) the vendee procures another third-party loan and that

lender would also have to agree to accept a second priority position behind the vendee's mortgagee based upon the equitable conversion theory. Third-party purchase money financing to pay off a land contract and acquire the fee simple estate will disappear. Is this the result the RPLS has considered? In any event, Michigan law does not support this result.

The reason and fairness of the Court of Appeals' decision is undeniable. The amount necessary to preserve the equity of a vendee and permit it to acquire the fee simple estate will *never* be any more than the amount outstanding on the land contract. A vendee will be able to acquire the fee simple estate without prejudicing a mortgagee of the vendee, and in fact, benefiting them in every case, by procuring the fee simple estate that is no longer subject to the possibility of a forfeiture, but only the statutory foreclosure remedies that afford so much more protection to the fee simple owner or owner of an estate in land. Accordingly, this Court must reject the application of "far-fetched" equitable theories that create inequitable results.

III. AMERICAN ACCEPTANCE IS EQUITABLY SUBROGATED TO THE RIGHTS OF THE LAND CONTRACT VENDORS WHO CONVEYED LEGAL TITLE TO THE VENDEE BASED UPON PAYMENT OF ITS PURCHASE MONEY MORTGAGE PROCEEDS.

A. American Acceptance has preserved the issue regarding the remedy of equitable subrogation.

American Acceptance raised the issue concerning application of the equitable subrogation doctrine to the trial court, but the issue was not addressed in its opinion. Again, this issue was raised in the Court of Appeals. However, the Court of Appeals rendered its opinion as a matter of law and found no need to decide the case upon application of this doctrine. *Graves* at 15, n12.

Regardless of its firm conviction that Court of Appeals' decision was correct as a matter of *law*, the case now lies within this Court's jurisdiction and before its final opinion is rendered, American Acceptance recognizes that an element of uncertainty exists, particularly since this

Court has already rendered an Opinion dated October 22, 2002 that peremptorily reversed the Court of Appeals but was subsequently vacated on January 28, 2003. Accordingly, in order to prevent an inequitable result to American Acceptance, it renews its previous requests in the Circuit Court and the Court of Appeals to apply the doctrine of equitable subrogation in this case, should it fail to agree with the Court of Appeals' decision rendered as a matter of law.

B. The undisputed facts and reasonable inferences.

This Court's determination of the applicability of an equitable remedy must necessarily be based upon the specific material facts before it. Pursuant to MCR 7.316(A)(6) the Court "...may, at any time, in addition to its general powers... (6) draw inferences of fact". The following are the undisputed material facts and the reasonable inferences to be drawn from them.

The land contract between Graves (then Eileen Pretto) and Diaz and the Giordanos was *never* recorded. Graves and Diaz were not timely in their payments under the land contract. In April of 1994, Graves was communicating directly with the Giordanos about the default under the contract, as evidenced by the letter from the Giordanos to Graves in April, 1994. Appellee Appendix 1b. The letter evidences that the Giordanos were not pleased with Graves and Diaz and the "aggravation" they suffered as a result of their default. The Giordanos informed Graves that they were going to forfeit the contract on April 11, 1994.

In Graves' Brief in Response to Defendants' [American Acceptance's] Motion for Summary Disposition dated May 27, 1998. Appellee Appendix 24b-39b. Graves recites her version of the events preceding the mortgage closing.

As of "early September of 1994", Graves and Diaz were communicating about the land contract. The "balloon payment" was due on August 25, 1994, and Graves was an original party to the contract. Based upon this fact, Graves had to know that the entire balance owing on the

contract was overdue. Diaz and Graves could no longer default and simply make up the payments after notice of forfeiture. Graves represents that "*[i]n that letter*, and in the telephone conversation which it confirmed, the Giordanos represented to Mrs. Graves that she would be given the opportunity to purchase the West End property before the Giordanos would foreclose the land contract". The letter does not recite that. More importantly, Graves does not recite that she objected to Diaz obtaining a mortgage or informed Diaz he could not do so without paying her *when* Diaz told her "...he was going to attempt to obtain a mortgage ..." to pay off the land contract. Graves recites that,"... in fact she did not believe that Diaz would be able to obtain the financing because of his poor payment history..." Being a real estate professional, Graves could not believe that her husband would be able to obtain a mortgage with the lien known to a lender. Was Graves concerned about that? What did Graves think was going to happen with the land contract since it was not paid in full on August 25, 1994, as she knew it had to be?

The property was originally purchased for $34,000 with a down payment of $3,400. Appellant's Brief Exhibit A. Seven years later, even assuming some appreciation of the property value, with Graves' lien against his interest, Diaz had virtually no equity to support a mortgage. If Graves, with her real estate knowledge, thought it unlikely that Diaz could get financing based upon his "poor payment history", how could she believe that he would possibly get a mortgage loan when his entire equity was subjected to her lien? The only reasonable inference of fact is that she knew her lien would prevent Diaz from obtaining a mortgage, that the Giordanos would forfeit the contract, and that her lien on his equity would be lost. She relates that she did not know about a particular lender. However, did she *not* know about the scheduled date for closing from Diaz? She was communicating with him, and she must have been very concerned about the default now that the entire balance was overdue.

She does not recite that she tried to contact his proposed mortgage lender to advise it that she had an unrecorded lien. Instead "[o]n her attorney's advice, Mrs. Graves recorded her Judgment of Divorce with the Oakland County Register of Deeds on September 7, 1994 at 8:54 a.m..." Was it a *coincidence* that Graves recorded the Judgment at 8:54 a.m. in the morning of the day of the mortgage closing? A reasonable inference of fact is that it was not. Graves is a Realtor in Oakland County. As such she is familiar with the need to record documents timely, as well as the inability of anyone searching the Oakland County Register of Deeds' records to discover a Judgment that was recorded just hours before the closing. Did she think that recording the lien would assure that the lien would be *discovered* by the mortgage lender (or a title company searching for the lender) and that she would be paid at the closing?

Graves indicates that she "assumed that she would be notified before any foreclosure proceedings" and that she would have "the opportunity to purchase the West End property before the Giordanos would foreclose the land contract." However, she could not do this, even if she had the funds necessary to do so, because she was no longer a party to the land contract. (It appears highly unlikely that Graves had the ability to pay the land contract balance in any event.) Graves would have to foreclose her lien against Diaz equitable title and *then* purchase the property from the Giordanos. Timing would be a substantial problem, however, because Diaz' redemption period on the lien foreclosure would be six months and since she and Diaz paid less than 50% of the land contract price, the time to satisfy a judgment for forfeiture obtained by the Giordanos would only be 90 days.

Graves simply could not allow American Acceptance to have notice of the lien, because it would then refuse to make the loan to Diaz, guaranteeing the forfeiture. However, she was advised to record the lien. So, she thought that it would make a difference in some way, but

perhaps not to the extent that she now argues – that her lien is first and American Acceptance has to pay her, rather than the other way around. In any event, she needed to record her lien, but not let Diaz' lender discover it. What could she do? Recording at the last possible moment accomplished both objectives. At the very least, she knew that her lien would be safe for the time being, because the Giordanos were paid and she still had a lien against Diaz. Diaz' right in the property was very tenuous without the mortgage. Recording her judgment lien immediately before the mortgage closing when it was impossible for the lender to discover it set the "snare".

Graves removed the *fairness* from the purpose of recording and subverted the specific intent of the legislature to protect subsequent purchasers. Graves was not being equitable. An equitable remedy corrects what may not be fair in the law. All of these facts and their inferences evidence that Graves knew exactly what she was doing by waiting until the morning of the very day of closing to ensnare the unsuspecting American Acceptance.

B. Application of the doctrine of equitable subrogation to these facts.

This Court's opinion in *French v Grand Beach Co*, 239 Mich 575, 215 NW 13 (1927) recites the basis of the equitable subrogation doctrine and supports the application of the doctrine to the facts in this case. In *French,* this Court stated:

> The doctrine of subrogation rests upon the equitable principle that one who, in order to protect a security held by him, is compelled to pay a debt for which another is primarily liable, is entitled to be substituted in the place of and to be vested with the rights of the person to whom such payment is made, without agreement to that effect. This doctrine is sometimes spoken of as "legal subrogation," and has long been applied by courts of equity. *Stroh v O'Hearn,* 176 Mich 164, 177.
>
> ***
>
> In speaking of subrogation, it was said in *Stroh v O'Hearn*:
>
> "It is proper in all cases to allow it where injustice would follow its denial, and in allowing it all injustice should be guarded against so far as possible."

> The cases in which this doctrine is applied, and the reasons therefore, are stated at length in 25 R.C.L. p 1337, et seq. (Secs. 22, 23). We quote therefrom but one sentence:
>
> > This is a just and reasonable rule. It effects the intention of the parties, preserves to the payor the benefit of his payment, leaves the inferior lienor in his former position, inflicts no injury upon him, prevents injury to the payor through mistake or ignorance of the inferior lien, and works exact justice to all.

French at 580-581.

In *Schanhite v Plymouth Savings Bank*, 277 Mich 33, 268 NW 801 (1936) this Court also applied the doctrine to subrogate a mortgagee to the position of a prior mortgagee whose mortgage was discharged after being paid off by a subsequent mortgage. This Court stated:

> Equity should lend an attentive ear to those, who, acting in good faith, seek to preserve the mortgage security against the possibility of tax sales and where the rights of innocent parties have not intervened.

Schanhite at 40.

Graves does not ague that the American Acceptance Mortgage deprived her of "the opportunity to *purchase* the West End property before the Giordanos would foreclose the land contract." She obviously could not purchase the property in September of 1994. She did not have that right. However, after Diaz owned the Giordanos' fee simple title subject to the American Acceptance mortgage she had a greater right as against Diaz. Rather than a lien on an inferior estate in land that was doomed to be lost to forfeiture, Graves' lien was preserved. She now had an opportunity, as a junior lien holder to purchase the property at the American Acceptance foreclosure sale. She did not do this however. Instead, she simply demanded that the unwitting victim of her recording "snare" pay her off.

Graves now argues that "[t]he Court of Appeals effectively wiped out Graves only hope to secure her court ordered property settlement and child support". Graves' Brief at 26. That is certainly *not* the case. Graves brought her situation with Diaz upon herself. Much more unfairly, she has dragged an innocent party into her self-created problems.

Graves now asserts that she is a victim of "... a clear injustice ..." and suggests that the Court consider an equitable remedy for *her*. However, she never exercised any of her rights, other than pursuing her current arguments that lack any basis in law or equity. When Graves and American Acceptance appeared before Judge Gene Schnelz for a scheduled hearing upon American Acceptance's Motion for Summary Disposition April 23, 1997,[3] Graves represented to American Acceptance that she could obtain from Diaz a voluntary deed "in lieu of foreclosure" naming both American Acceptance and Graves as grantees. (Tr, 04/23/97, pp 2-9); Appellee Appendix, 10b-19b. She would list and sell the property and the proceeds would be paid first to American Acceptance for the taxes and insurance it had paid to preserve the property, and the balance of the proceeds paid to American Acceptance and Graves in the amounts of their respective liens. Graves would receive the excess funds to settle with Diaz. If the proceeds were less than the amounts owed on the mortgage and lien, the court would only then be requested to rule on the priority issue. Graves did not procure the deed, and pursuant to the settlement, American Acceptance foreclosed its mortgage on June 10, 1997. (The case was later reassigned to Judge Alice Gilbert.) Graves never took any action to foreclose her lien.

From the time that Graves first contacted American Acceptance after the mortgage closing had saved her lien, she has simply demanded that *it* pay Diaz' entire lien amount. Instead

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[3] The cover page of this Transcript is misdated as April 23, 1998.

of taking any action to preserve the property, Graves left that to American Acceptance who, in fact, paid the delinquent taxes and insurance and then renovated the property after Diaz had failed to maintain it. Graves has evidenced a substantial degree of duplicity throughout this case. She who seeks equity must do equity.

As already noted, Diaz could not produce a copy of the land contract to American Acceptance prior to or at the closing. Graves also was unable to produce a copy during the trial court proceedings. American Acceptance first obtained a copy as an Exhibit to Graves' brief filed in the Court of Appeals. Considering it disclosed the default in the final "balloon" payment, it is apparent that disclosure would evidence that she needed the mortgage as much if not more than Diaz. Based upon the status of the land contract in early September, 1994, Graves and Diaz were desperate. It is reasonable to infer that she and Diaz were communicating about the mortgage to the very day of closing and neither wanted to inform American Acceptance. It is also reasonable to infer that Graves and Diaz failed to provide notice to American Acceptance of the lien created by the Judgment in concert with one another. At the mortgage closing with American Acceptance, Diaz executed an owner's affidavit that failed to disclose any lien in favor of Graves. Appellee Appendix 3b. Diaz perpetrated a fraud on American Acceptance; Graves enabled that fraud to occur. Even if the Court agrees that Michigan law establishes that American Acceptance's purchase money mortgage has priority over Graves' lien as of a matter of law, American Acceptance would never have made the loan to Diaz knowing he had no equity in the property.

As a matter of equity, as well as a matter of law, American Acceptance is equitably subrogated to the rights of the Giordanos as the owners of the fee simple estate acquired by the proceeds of the American Acceptance purchase money mortgage. American Acceptance not only

paid Graves' personal obligation to the Giordanos but it acquired the fee simple estate for Diaz and preserved Graves' lien on Diaz' equitable estate. As discussed, Graves had no interest in the fee simple estate because Diaz did not own it. Graves herself understood that she had to "purchase" the fee simple estate from the Giordanos, not pay off a mortgage, as she now argues. After acquiring the legal title for Diaz and Graves, American Acceptance preserved its interest in the mortgage on the legal title afterwards by paying the delinquent taxes and insurance and renovating the property after Diaz was foreclosed. Graves' cite to cases addressing a "mere volunteer" are irrelevant. Graves had no lien on the interest acquired by American Acceptance. The same rationale would apply as does with the purchase money mortgage doctrine. "But for" the mortgage, Diaz and Graves would not have acquired the legal title, and in this case, they were nearly certain to lose their right to acquire it. This is also *precisely* the reasoning behind the priority status given to purchase money mortgages enunciated in the previously cited cases and supporting authority.

Equitable subrogation puts American Acceptance in the same position as the Giordanos. Graves and Diaz still have harmed it. Litigation is time consuming and costly. These costs will never be recovered. On the other hand, Graves had substantially *benefited* by the mortgage because she and Diaz owed the same amount they did before the mortgage, but afterwards, they both had substantially more opportunity to work themselves out of their financial difficulties. She failed to act on this opportunity or the additional opportunity to utilize her skills as a real estate professional as she indicated she could do in April of 1994.

American Acceptance became the owner of the West End property by virtue of the foreclosure of its mortgage. Graves' failed to redeem from the foreclosure and lost her lien on Diaz equity. There was nothing inequitable about requiring Graves to pay off the first mortgage

on the property in order to preserve her lien against Diaz' equity. Quite the contrary, it is completely inequitable to require American Acceptance to pay off Graves' lien, when she *never* had any interest in the fee simple estate title other than what she may have obtained through Diaz after he acquired it subject to the mortgage.

It would be inequitable to benefit Graves with a windfall when it is evident that her neglect and purposeful actions caused this situation to occur. This Court may be hard pressed to find a case with facts that are more compelling for the application of the doctrine of equitable subrogation. All of Graves' arguments in this case, but most particularly those relating to application of equitable principles, make a mockery of the law. Without any facts or reason to support her "argument", Graves claims that the Court of Appeals decision was "...a clear injustice to Eileen Graves...". Graves Brief, at 26. The Court of Appeals understated the obvious when it stated:

> We do not view our recognition of the priority of the instant purchase money mortgage, which enabled Diaz to obtain legal title to 72 West End, as an inequitable result. *Graves* at 14.

CONCLUSION

The arguments by appellant on appeal advance theories that are unsupported by Michigan law and are contrary to statutory and decisional law. Michigan recording laws do not apply to prior purchasers of after-acquired real estate interests, and such attempted application subverts the clear language and legislative intent of these statutes to protect subsequent purchasers of real estate interests. The doctrine of equitable subrogation is applicable to a purchase money mortgagee whose mortgage proceeds are used by a land contract vendee to acquire the fee simple title.

RELIEF REQUESTED

Defendants-Appellees, American Acceptance Mortgage Corporation and Boulder Escrow, Inc., respectfully request that this Honorable Court affirm the decision of the Court of Appeals and remand to the trial court for entry of judgment in their favor pursuant to its decision.

By: _____

MICHAEL J. HAGERTY (P29254)
Attorney for Defendants-Appellees
American Acceptance Mortgage
Corporation and Boulder Escrow, Inc.
622 East Grand River Ave.
Howell, Michigan 48843
(517) 548-3130

DATED: May 2, 2003

STATE OF MICHIGAN
IN THE SUPREME COURT

(ON APPEAL FROM THE MICHIGAN COURT OF APPEALS)
SAWYER, P.J., JANSEN AND GAGE, J.J.

EILEEN V. GRAVES,

Plaintiff-Appellant,

v

AMERICAN ACCEPTANCE MORTGAGE CORPORATION,

Defendant-Appellee,

and

BOULDER ESCROW, INC., a Nevada Corporation,

Defendant-Appellee/Counter and Cross-Plaintiff.

and

STEVE DIAZ,

Defendant/Counter and Cross-Defendant.
_____/

Supreme Court No. 119977

Court of Appeals No. 215141

Oakland County Circuit Court
No. 96-511648-CZ

CERTIFICATE OF SERVICE

STATE OF MICHIGAN)
) ss.
COUNTY OF WAYNE)

Michael Hagerty, being first duly sworn, deposes and says that he is an attorney with the Metropolitan Title Company, and that on the 2nd day of May, 2003, caused to be served two copies of Defendants-Appellees' Brief on Appeal, Oral Argument Requested, and Certificate of Service upon the following:

Ronn S. Nadis, Esq.
Michael K. Dorocak, Esq.
Attorneys for Plaintiff-Appellant
Eileen V. Graves
29201 Telegraph Road
Suite 510
Southfield, MI 48034

by enclosing same in a pre-addressed, pre-stamped envelope and depositing same in the United States Mail.

MICHAEL J. HAGERTY

Subscribed and sworn to before
me this 2nd day of May, 2003.

Laura A. Baird, Notary Public
St. Clair County, Michigan
Acting in Wayne County, Michigan
My Commission expires: 01/15/2004

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